

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 01-0108
Use Tax
For the Years 1998, 1999, and 2000

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ISSUE

I. Sampling Methodology - Use Tax.

Authority: IC 6-2.5-1-1 et seq.; IC 6-2.5-3-2(a); IC 6-2.5-3-2(c); IC 6-2.5-3-2(c)(1); IC 6-8.1-5-1(b); Great American Lines, Inc. v. Ind. Dept. of State Revenue, 2000 Ind. Tax LEXIS 55 (Ind. Tax Ct. Dec. 28, 2000).

Taxpayer argues that the method used by the audit to determine its use tax liability was flawed.

STATEMENT OF FACTS

Taxpayer is an Indiana construction contractor. It provides services and materials to commercial, industrial, and government customers. The Department of Revenue (Department) conducted an audit of taxpayer's business records. The audit found that taxpayer owed use tax on particular items for which it should originally have paid sales tax. Accordingly, the Department sent taxpayer notices of "Proposed Assessment." Taxpayer decided that the amounts were excessive and submitted a protest to that effect. An administrative hearing was held during which taxpayer explained the basis for its protest, and this Letter of Findings results.

FINDINGS

I. Sampling Methodology - Use Tax.

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC 6-2.5-1-1 et seq. The use tax "is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC 6-2.5-3-2(a). Use tax must be paid when a contractor – such as the taxpayer – buys materials it intends to use to construct a building for one of its customers. "The use tax is imposed on the addition of tangible personal property to a structure or facility, if, after its addition, the property becomes part of the real estate on which the structure or facility is located." IC 6-2.5-3-2(c). However, a contractor is not required to pay the use tax if "the state gross retail or use tax has been previously imposed on the sale or use of that property." IC 6-2.5-3-2(c)(1).

Taxpayer agrees that it should have been assessed use tax on certain items it purchased for which it did not originally pay sales. However, taxpayer challenges the specific methodology used by the audit to calculate its three-year use tax liability. The audit did not examine in detail the

purchase records for all three years. Instead, the audit chose one year – 1999 – examined all of taxpayer’s purchases for that year, and made a determination as to which of those 1999 purchases were subject to use tax. Thereafter, “The auditor and the taxpayer agreed that an error ratio of additional variable taxable purchases, to a variable such as sales per Federal Form 1120, would be used to project the additional variable taxable purchases for the years [1998] and [2000].” Assuming, for example, that 10 percent of taxpayer’s 1999 purchases were subject to use tax, the audit and taxpayer agreed that 10 percent of taxpayer’s 1998 and 2000 purchases would also be subject use tax without the necessity of examining each and every one of the purchases made during 1998 and 2000.

Taxpayer does not challenge the use of this method of calculating its three-year use tax liability because taxpayer plainly agreed to the method. Taxpayer signed an “Agreement for Projecting Audit Results” to that effect. Instead taxpayer challenges the accuracy of the final result because the 1999 base year percentage was skewed to reflect a greater than typical percentage of taxable purchases to total purchases. Taxpayer points out that the audit included – as subject to use tax – two specific 1999 purchases it made from a steel vendor. Taxpayer bought fabricated steel from this steel vendor which taxpayer then used to complete construction projects for one of its regular customers, a steel manufacturer.

Plainly, the two purchases from the steel vendor were subject to use tax because the fabricated steel was tangible personal property later incorporated into a structure on the steel manufacturer’s real estate. IC 6-2.5-3-2(c).

Nevertheless, taxpayer maintains that these two specific purchases should be deleted from the 1999 base calculation or, at least, discounted in arriving at the 1999 base. Taxpayer explains stating that, in the normal course of its dealings with this particular steel manufacturer, the steel manufacturer typically supplied to its own fabricated steel for construction projects at its location. Therefore, taxpayer concludes that the two 1999 purchases from the steel vendor were atypical, did not represent the normal course of dealings with the steel manufacturer, and the inclusion of the two purchases into the 1999 base resulted in an over assessment of 1998 and 2000 use tax.

The taxpayer’s 1998, 1999, and 2000 proposed use tax assessments are presumed correct, and the burden is on the taxpayer to prove that these assessments are wrong. IC 6-8.1-5-1(b). Taxpayer has not demonstrated that the assessments are wrong; taxpayer has demonstrated that the two 1999 purchases are “outliers,” statistical observations which – their face – appear to deviate markedly from other members of the 1999 base sample and are not representative of the sampled year. *See Great American Lines, Inc. v. Ind. Dept. of State Revenue*, 2000 Ind. Tax LEXIS 55 (Ind. Tax Ct. Dec. 28, 2000). Accordingly, the audit is requested to reconsider the 1999 base determination and issue a revised 1998, 1999, and 2000 use tax assessment.

FINDING

Taxpayer’s protest is sustained.